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SECOND CIRCUIT REVIEW

Expert Analysis

Construing Land Sales Act to Prevent Revocation of Apartment Purchase

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This month, we discuss *Bacolitsas v. 86th & 3rd Owner LLC*,[1] in which the U.S. Court of Appeals for the Second Circuit reversed a lower court decision granting plaintiffs summary judgment on their claim for revocation of an executed purchase agreement for a luxury condominium unit in New York City. The court's opinion, written by Judge Peter W. Hall and joined by Judge Raymond J. Lohier Jr. and Judge Robert D. Sack, considered a matter of first impression in this circuit: whether the Interstate Land Sales Full Disclosure Act (ILSA)[2] requires that the description of the lot, as opposed to the agreement in which that description is embedded, be "in a form acceptable for recording."

ILSA. Enacted in 1968, ILSA was "designed to prevent false and deceptive practices in the sales of unimproved tracts of land by requiring developers to disclose information needed by potential buyers."[3] The *Bacolitsas* case turned on the reading of §1703(d), which provides:

> Any contract or agreement which is for the sale or lease of a lot… and which does not provide—
>
> (1) a description of the lot which makes such lot clearly identifiable and which is in a form acceptable for recording by the appropriate public official responsible for maintaining land records in the jurisdiction in which the lot is located;
>
> may be revoked at the option of the purchaser or lessee for two years from the date of the signing of such contract or agreement.

Section 1703 was enacted as part of a 1979 amendment.

Until the real estate market crashed, ILSA was invoked infrequently; nationwide, only 10 to 20 ILSA court decisions were issued annually. The Second Circuit had not had occasion to review ILSA since the 1970s. Those numbers increased dramatically in 2009 and 2010. According to *The Real Deal*, a New York real estate publication, in December 2009 buyers of at least 131 New York City condominium units worth $132 million were seeking to use ILSA to back out of their deals. As the U.S. Court of Appeals for the 11th Circuit noted, ILSA has become "an increasingly popular means of channeling buyer's remorse into a legal defense to a breach of contract claim."[4]

The Subject Transaction. In May 2008, Vasilis Bacolitsas and Sofia Nikolaidou (plaintiffs) entered into an agreement with defendants to purchase Unit 20A in the Brompton, a luxury condominium on the Upper East Side, for $3.4 million. The agreement, consistent with industry practice, expressly prohibited plaintiffs from recording it. By January 2009, plaintiffs had paid a total of $510,000 toward the deposit, or 15 percent of

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the purchase price. In March 2009, *The New York Times* reported on buyers, struggling with adverse financial conditions, using ILSA to get out of their contracts.[5]

The article noted that nearly 30 buyers at the Brompton were considering their options. Shortly after the article was published, plaintiffs sought a $600,000 reduction in the apartment's purchase price, which was rejected. Plaintiffs did not make a further payment of $170,000, due on March 15, 2009; accordingly, defendants terminated the agreement. The agreement had contained a liquidated damages provision.

Plaintiffs challenged the termination with the Office of the New York Attorney General. In January 2010, the attorney general issued a decision finding that plaintiffs had defaulted on the agreement and that defendants were entitled to the $510,000 deposit. Meanwhile, in July 2009, notwithstanding the fact that defendants had already terminated the agreement, plaintiffs notified defendants that they were revoking the agreement pursuant to ILSA for (1) failing to provide an adequate description of the property pursuant to §1703(d)(1), and (2) containing an invalid liquidated damages clause in violation of §1703(d)(3). Defendants rejected plaintiffs' purported revocation.

The District Court Case

In August 2009, plaintiffs filed suit seeking both a declaration that they had validly revoked the agreement pursuant to ILSA and also an award of $510,000 in money damages. Following discovery, both parties moved for summary judgment. The district court's opinion focused exclusively on the text of §1703(d). The court found that "[a] 'description,' standing independently from the legal instrument in which it is contained," is not recordable.[6] The court went on to address whether the agreement itself was recordable. Under New York law, such a contract can be recordable where it has been "acknowledged or proved, and certified, in the manner to entitle a conveyance to be recorded…."[7] Neither party argued that the agreement had been acknowledged and the court therefore found that the agreement "was not in recordable form and [was] subject to rescission under section 1703(d)(1) of ILSA."[8]

> Contrary to the findings of the district court, the Second Circuit held that ILSA does not require a standalone description of a lot to be recordable.

The decision received immediate attention in the press. Plaintiffs' lawyer told *The New York Times*, "This case allows every buyer in a newly constructed condominium which has sold more than 100 units within the last three years to obtain a refund of their down payment."[9] With the potential for such far-reaching consequences, it is little surprise that the Real Estate Board of New York joined defendants' appeal as amicus curiae.

Second Circuit's Decision

Interpreting ILSA. Like the district court, the Second Circuit began its analysis with a textual interpretation of §1703(d)(1). The court found that "[t]he phrase 'which is in a form acceptable for recording'…modifies the word 'description' at the beginning of the same sentence, not the more distant nouns 'contract or agreement' located in the prior section.'"[10] Accordingly, the panel determined that whether the contract in which the description is found was itself recordable is irrelevant. Moreover, contrary to the findings of the district court, the Second Circuit held that ILSA does not require a standalone description of a lot to be recordable. The Second Circuit ruled that the district court impermissibly imposed requirements that Congress, in drafting ILSA, had not.

The panel went on to discuss ILSA's underlying purpose—providing adequate information to potential buyers. The court concluded that ILSA's purpose was furthered by ensuring that a description of a lot provide sufficient detail to satisfy the local recording statutes, but not necessarily that it satisfy the technical requirements for recordability.

Applying ILSA. Having addressed the statutory requirements of ILSA, the Second Circuit turned to whether the description provided in the agreement satisfied those requirements, an analysis the district court had not undertaken. In deciding not to remand, the court noted that judicial economy weighed in favor of making the determination at the circuit level because the issue had been fully briefed and argued below, and presented clear questions of law.

Plaintiffs argued that the "description," to be "in a form acceptable for recording," must contain the requisite information of a condominium

unit deed under New York's Condominium Act. These details include "the liber, page and date of recording of the declaration,"[11] which the description in the agreement admittedly did not contain. The court rejected this argument, finding no basis to conclude that ILSA mandated that the "description" contain information identical to that required for an instrument that is ultimately used to convey the unit. The panel noted that, in enacting ILSA, Congress was not attempting to regulate conveyance, but rather was concerned only with disclosure.

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The Second Circuit went on to highlight industry practice to support its rejection of plaintiffs' arguments. The court noted that tax lot numbers can only be assigned to a unit upon completion of construction. These numbers are typically required to file a condominium declaration. Under plaintiffs' interpretation, a purchase agreement could only be executed after construction was finished, as this would be a necessary precondition to obtaining the "liber, page and date of recording of the declaration" required for the deed.

Not only did the court find such a result at odds with long-standing industry practice, but it also noted that Congress had evidenced its awareness of pre-completion sales. Under ILSA, subdivision is defined as land that "is divided or is proposed to be divided into lots…for the purpose of sale." Accordingly, since Congress envisioned a system where a lot may merely be proposed at the time a contract for purchase is executed, Congress could not have contemplated requiring the level of detail necessary for recording a deed in the description found in a pre-completion contract.

Having rejected plaintiffs' position, the court turned to the actual description of Unit 20A included in the agreement. The panel held that the description of Unit 20A was in a form acceptable for recording pursuant to §1703(d)(1). The description identified the apartment as Unit 20A, delineated Unit 20A on the condominium's floor plans and included that unit's particular floor plan. Unit 20A's floor plan showed the dimensions and locations of the rooms and windows, the location of the unit within the building, and the direction the unit faced. The Second Circuit found this level of detail sufficient to comply with the requirements of ILSA.

In a final attempt to revoke the agreement pursuant to §1703(d)(1), plaintiffs argued that this description was inaccurate. Plaintiffs pointed to the draft declaration, which indicated that the Brompton would occupy the "volume of space…which lies above the horizontal plane having elevation of 90.52 feet" above ground level. This inaccuracy was later corrected by the actual declaration filed in February 2009. The court found this variance immaterial. Not only did other documents provided to plaintiffs indicate that the Brompton would not begin in mid-air, but also this inaccuracy did not impact the description of plaintiffs' 20th-floor apartment, which did not occupy the omitted ground floor level. Importantly, §1703(d)(1) relates to the description of the individual unit, not the condominium as a whole.

The court turned briefly to plaintiffs' argument that the agreement was revocable under ILSA because the liquidated damages clause violated §1703(d)(3). The panel summarily determined that this claim was entirely without merit.

Conclusion

The Second Circuit's decision in *Bacolitsas* provides some much-needed clarity regarding the requirements of ILSA. Developers will no doubt rest easier knowing that executed contracts on units in buildings with more than 100 units will not remain revocable for two years simply because no deed has been recorded. Stymied by the Second Circuit, buyers likely will continue to look for other creative ways to protect their interests in a market that collapsed during the financial crisis.

1. Docket No. 10-4229-cv, 2012 WL 6602795 (2d Cir. Dec. 19, 2012).
2. 15 U.S.C. §§1701-20.
3. *Flint Ridge Dev. v. Scenic Rivers Ass'n of Okla.*, 426 U.S. 776, 778 (1976).
4. *Stein v. Pardigm Mirasol*, 586 F.3d 849, 852 (11th Cir. 2009).
5. Grynbaum, Michael M., What Contract?, *New York Times*, March 8, 2009.
6. *Bacolitsas v. 86th & 3rd Owner LLC,* No. 09 Civ. 7158 (PKC), 2010 WL 3734088, at *6 (S.D.N.Y. Sept. 21, 2010).
7. N.Y.P.R.P.L. §294(1).
8. 2010 WL 3734088, at *7.
9. Bagli, Charles V., "Condo Ruling May Let Many Cancel Deals," *New York Times*, Sept. 23, 2010, at A30.
10. 2012 WL 6602795, at *4.
11. N.Y. Real Prop. L §339-o.